GEO

Guyana Economic Opportunities

A Private Sector Development Bank for Guyana
A Concept Paper

For
The Guyana Manufacturers' Association

Prepared by:
Osborne Nurse

Submitted by:
Chemonics International Inc.

To:
United States Agency for International Development
Georgetown, Guyana

Under Contract No. 504-C-00-99-00009-00

December 14, 1999

TABLE OF CONTENTS

1 Executive Summary

With the effective closure, in 1994, of the Guyana Agricultural and Industrial Bank, which performed the services of a development bank in the financial system, a number of entrepreneurs have expressed the need to have a new development bank established under private sector ownership.

Although development banks in the region have generally performed poorly, the strong performance of the few private development finance institutions in the Region gives strong encouragement to the concept of establishing a similar institution in Guyana. Further encouragement is given by the existing context of a financial sector that essentially offers limited access to long-term loans to existing and new entrepreneurs.

As the establishment of such an institution is being contemplated, promoters of the proposal need to bear in mind certain of the lessons of development financing institutions in the Region and elsewhere.

The following are some of the clear lessons to be learnt from the regional, and to a significant extent, worldwide experience with development banks:

- Proper governance and good management are critical;
- Political interference must be minimised;
- Management authorities must be clearly defined and observed;
- The banks should be required to satisfy generally accepted prudential criteria;
- Management of the loan portfolio including selection, documentation, monitoring and collections must be of the highest quality and consistency
- The ability to diversify risks is likely to assist in maintaining long-term profitability of the bank;
- The banks must institute effective information systems capable of providing management with all the information needed to properly manage the bank.

1.1 Objectives of the Proposed Bank

The objectives of the proposed bank may be summarised in the following terms:

- To provide long-term project financing for new or expanding businesses;

- To provide other financial services needed by its clients including short term trade finance and other financial services;

- To facilitate the further development and widening of the financial markets in Guyana;

- To explore and develop partnership and co-operative relationships with other domestic and foreign financial service providers;

- To identify and secure sources of long term financing including domestic and external sources;

- To develop appropriate tools and systems to facilitate the growth and availability of domestic financial resources.

1.2 Ownership, Capital and Governance

Some of the key elements in relation to the establishment of the proposed new bank will include:

- Formation of a company under the company laws;
- Application for a license under the provisions of the Financial Institutions Act, 1995;
- Subscription of the required minimum capital as specified in the FIA;
- Ensuring as wide as possible participation in the equity of the bank among all segments of the private sector;
- Approaching other external agencies such as the CDB for contributions to capital;
- Ensuring that the Board of Directors is as free as possible from undue influence from any one or group of directors or shareholders, and indeed from the government;
- Ensuring that the bank's private sector status is confirmed by restricting any government participation in its equity to a relatively small minority.

1.3 Market Strategy and Services

The establishment of the bank must be based on confirmation, through appropriate research and market analysis, of a sustainable and competitive demand for its services. The initial evidence suggests that given the limitations of the existing sources of finance, there is indeed likely to be a demand for development banking services, but it is the sustainability of such demand that is the critical issue. Based on the existence of such a demand the bank may offer a wide range of financial services, including:

- Project finance
- Foreign exchange finance;
- Export financing;
- Credit enhancement facilities;
- Creating primary and secondary markets for domestic securities.

The bank's ability to deliver such services will depend on its capacity to obtain the required long-term funding from both the domestic and foreign markets, including the CDB and other multilateral financing institutions.

1.4 Role of Government

The government should consider assisting in the creation of the new bank by any of the following mechanisms:

- Accepting a minority equity position in the bank;
- Supporting any applications that the bank may make for equity and/or long-term funding from the CDB and other international financial institutions;
- Using the banks as an intermediary in special programmes;
- Granting the bank tax free privileges for raising domestic funds;
- Encouraging the bank, through appropriate policy measures, to widen the financial market;
- Continuing the policy towards the reduction of interest rates in the domestic market.

1.5 Options for Establishment

The following table summarises the options for establishing the bank and identifies some of the pros and cons of each option. Once the preferred option has been decided upon the promoters of the bank should immediately embark on the next steps towards its establishment, including appointing an Implementation Team, undertaking a market feasibility analysis and establishing the company.

Options for the Formation of a Development Bank in Guyana

Option	Pros	Cons
A Bank Wholly Owned by the Guyana Private Sector	• Achieves initial objective of private Sector	• Highest expected cost of start-up; • Capital resources may not be available; • Ownership may be highly concentrated; • Skill resources may be scarce; • Potential for strong influence by key persons
A Joint Venture Between An External Bank and the Private Sector	• Capital resources may be more readily available; • Managerial and technical skills may be available from partner; • Balance provided for strong local influences	• Reduced ownership by locals
A Subsidiary of an External Bank with Minority Domestic Interest	• Similar advantages to joint venture	• Local ownership further reduced
Services Provided by External Bank Without Physical Presence in Guyana	• No resources required from local promoters	• Best projects may be “cherry-picked” • No participation by locals • Supervision by BOG may be limited
Encouraging Development Finance “Windows” in Commercial Banks	• Meets “private sector” criterion; • Local banks involved; • Early start-up; • Existing framework and resources.	• Risk profile may be influenced by deposits as source of funding

2 Introduction and Background

The Guyana Manufacturers' Association (GMA) has requested the USAID/Guyana Economic Opportunities Project (GEO Project) to assist the Association to respond to the invitation by the Guyana President for the private sector to prepare a Concept Paper for the establishment of a development bank for which they had been asking. This Report has therefore been prepared under the aegis of the GEO Project in response to that request.

Up to 1994, the Guyana Agricultural and Industrial Bank (GAIBANK) performed the services of a development bank within the economy. The institution performed poorly, and the Government determined, within the context of the Structural Adjustment Programme on which it had embarked, to merge GAIBANK with the Guyana National Commercial Bank (GNCB) and to effectively close the institution.

As a consequence of this decision, there no longer existed a financial institution dedicated to the provision of long-term development project finance, and members of the manufacturing sector, in particular, have repeatedly called for the re-establishment of such an institution. Partly on account of the conditions applicable under the SAP, and partly on account of a revised philosophy about the role of the private sector in the economy, the government challenged the private sector to develop a proposal for the establishment of a development bank.

In so doing, the government made it clear that it did not wish to own or run such an institution, and that it would expect the private sector to raise the necessary equity and long term funding sources that would be required. The government did, however, promise that it would play its full part in providing the environment and framework that would facilitate the establishment of a development bank owned by the private sector. To the extent that this support would mean the provision of certain incentives and supports, the government indicated its willingness to provide such incentives, within the limits of it fiscal capacity and the conditions applicable under the SAP.

In the period since the initial discussions were held on the possible establishment of a new development bank, very little had been done to further the development of the proposal. Recently, however, at a seminar and consultation with the business sector, the President reminded participants about the issue and requested that a Concept Paper be prepared and submitted to the government for its consideration.

Against this background, the GMA approached the GEO Project, and the current assignment became a reality.

2.1 Terms of Reference of the Assignment

The assignment involved two tasks. Firstly, the Consultant would present a seminar to the GMA - and other members of the private sector and parties interested in the development of the bank – on the issues and problems of development banking and the considerations to be taken into account in the formation of a development bank.

The second task of the assignment is for the Consultant to prepare a Concept Paper on the potential establishment of a development bank in Guyana.

The Concept Paper would then presumably form the submission or the basis of a submission to be made to the President in response to his request.

2.2 Methodology

The assignment was a short one, to be conducted over one week in Guyana. The first task of conducting the seminar was executed on day two of the assignment and was conducted by the Consultant on the basis of his experience of development banking issues in the Caribbean and elsewhere.

The second task was executed by taking into account the comments made at the seminar and the views gleaned by the Consultant from visiting and meeting with the senior officials of a number of commercial banks, the Central Bank, the Ministry of Finance and the IADB Resident Representative.

The Report that follows represents the Consultant's recommendations based on the discussions held with the potential sponsors both at the seminar and outside of that forum, as well as with the other officials visited.

3 The Development Banking Concept

Development Banks, for the most part, were initially created as manifestations of the view that government action was needed to correct economic problems and advance national welfare. Another factor that applied in their initial creation was the fact that the multilateral institutions needed to have sound, respectable institutional instruments through which to make resources available to developing countries.

The objectives of these institutions have primarily been to provide long term project finance, fill the gap left by commercial banks, stimulate economic development, and facilitate execution of government economic strategy.

In this definition of the role of development banks, the banks were restricted to lending for capital expenditure on buildings, equipment, furnishing and fittings. Lending was restricted to the productive sectors such as agriculture, industry and tourism, and more recently in small and medium enterprises, low income housing and student loans for university level study.

The definition also precluded investment in the refinancing of debts, land acquisition, working capital and commercial lending.

3.1 Development Bank Performance in the Region

As financial institutions, the performance experience of the public sector development banks in the region has not been very positive, although there are examples of banks that have indeed performed quite well. To a considerable extent the poor performance has related to issues of governance in circumstances where Boards have been appointed by government, which in many cases has produced political interference in the lending and appointment decisions of the bank.

The second factor that has resulted in the poor performance of the banks has been the quality of their management in terms of their selection, evaluation, performance and compensation.

The result for many of these development banks has been a level of profitability that has been marginal or negative. Low profitability has been the result of the growth of credit portfolios of poor quality deriving from poor selection and monitoring and management of loans, followed by poor loan recovery efforts. In many instances the poor recovery effort has been justified by statements to the effect that the society is small, and that there is no market in which to sell secured properties.

The result has been that the development banks have generally encountered severe Solvency problems arising out of the need to make substantial Provisions for loan losses. Once the institutions have been required to make the necessary loan loss provisions they revealed a pattern of Several Years of Losses, which, accompanied by limited capital contributions by governments, have led to the Need for Restructuring or Closure of some of the institutions. Development banks have consequently been restructured in several countries - Trinidad (1986/7), Grenada, St. Kitts, BVI, and Jamaica – and at least one has been closed in Barbados. On the other hand there have been notable successes among both private sector development banks – Trinidad and Tobago, and at least until recently, in Jamaica – and public sector banks in St. Lucia, and Dominica.

The following are some of the clear lessons to be learnt from the regional, and to a significant extent, worldwide experience with development banks:

- Proper governance and good management are critical;
- Political interference must be minimised;
- Management authorities must be clearly defined and observed;
- The banks should be required to satisfy generally accepted prudential criteria;

- Management of the loan portfolio including selection, documentation, monitoring and collections must be of the highest quality and consistency

- The ability to diversify risks is likely to assist in maintaining long-term profitability of the bank;

- The banks must institute effective information systems capable of providing management with all the information needed to properly manage the bank.

3.2 Current Views About Development Banks and DFI's

Recent history has shown that the growth and production of welfare have been accompanied by more diverse needs for financial services that can no longer be satisfied by the simple dichotomous opposition of commercial bank vs. term financier. Commensurate with this is a growing willingness to recognise and define development as involving a broad variety of financial services that competitively and profitably mobilise intermediate domestic as well as foreign savings. Thus the commercial banks are tending to provide more term and project-lending services while the development banks are increasingly being called upon to provide more trade financing and other commercial services.

By this approach, any financial institution, financial or non-financial, which effectively and efficiently, fills one or more observable financial needs, provides a development service to the community.

With this new perspective on development banking, a development finance institution can look forward to having a wider role in the financial system, including taking initiatives to widen the system and financial markets themselves. Such an institution must expect to be able to compete directly with other financial institutions, but would need to select carefully the market niche in which it will operate and which will become the hallmark of its image and reputation.

4 The Guyana Financial Environment – A Brief Review

Seven commercial banks, two trust companies and the New Building Society comprise the core of the Guyana financial market. In addition there was a mortgage finance bank that ceased operations at the end of 1998. The Bank of Guyana under the provision of the Financial Institutions Act, 1995, supervises the commercial banks and trust companies. The New Building Society currently does not come under the purview of the FIA and is not supervised by the BOG.

4.1 Assets and Liabilities of the Financial Sector

Excluding the Bank of Guyana, the financial sector manages some GY$137.8 billion in assets. The commercial banks manage some 73% of these assets with insurance companies and the New Building Society each managing some GY$ 10.9 billion or approximately 8% each. Pension funds and the trust companies account for roughly equal shares of remaining assets, each managing approximately 5.5% of the assets in the system.

Assets and Liabilities of the Financial Sector 1998 Millions of Guyana Dollars			
Institutions	**Assets**	**Liabilities**	**Capital**
Commercial Banks	$100,495	$81,110	$19,385
Insurance Companies	$10,951	$5,882	$5,069
New Building Society	$10,922	$1,793	$9,130
Pension Funds	$7,725	$7,406	$319
Trust Companies	$7,741	$4,565	$3,176
Total	**$137,834**	**$100,756**	**$37,078**
Bank of Guyana	**$116,755**	**$105,617**	**$11,138**

Sources: Bank of Guyana: Banking System Statistical Abstract
Bank of Guyana: Annual Report and Statement of Accounts, 1998

These assets are matched by liabilities totalling GY$ 100.8 billion, once more with the commercial banks accounting for the lion's share at approximately 81% of all liabilities. The commercial banks also account for just over 50% of the capital in the sector.

The liabilities of the commercial banks and the trust companies are mainly in the form of deposits from both residents and non-residents. Deposits in the commercial banks amounted to GY$76.5 billion of which GY$ 4.1 billion were non-resident deposits. For the trust companies total deposits were GY$ 2.7 billion. A further GY$ 1.7 billion of trust companies' liabilities were in respect of loans payable.

The liabilities and capital shown for the insurance companies, pension funds and the New Building Society are of different kinds. Members' shares of the NBS are shown as part of their capital. In the case of the insurance companies the liabilities are primarily the insurance fund and foreign liabilities.

Deposits in the commercial banks therefore fund the main source of financing available from the financial sector. An examination of the maturity structure of the deposits will assist in understanding the structure of the markets for lending in Guyana. As indicated, the greater proportion of deposits in the sector is held by the commercial banks, and indeed the data that are available for further analysis are only available for the banks. The other holders of deposits are the trust companies, which hold time deposits. In the absence of further details about the structure of time deposits held by the trust companies, we assume that it will not differ significantly from the structure of time deposits at the commercial banks.

Guyana Financial Sector
Commercial Bank Deposits - Year End 1996 - 1999
$ Millions
Maturity Profile of Deposits

		1996	1997	1998	Aug. 1999
Residential					
Demand Deposits		$7,955	$8,354	$7,828	$7,792
Savings Deposits		$30,031	$34,514	$39,527	$37,685
Time Deposits		***$19,494***	***$23,091***	***$25,849***	***$28,837***
	Up to 3 Months	$16,909	$17,513	$17,021	$18,620
	3 to 6 Months	$1,908	$3,702	$5,151	$4,237
	6 to 9 Months	$0	$6	$3	$719
	9 - 12 Months	$254	$1,853	$3,655	$5,218
	Over 12 Months	$423	$17	$19	$43
Total Residential Deposits		**$57,480**	**$65,959**	**$73,204**	**$74,314**
Total Foreign Deposits		***$2,598***	***$3,748***	***$3,351***	***$4,184***
	Demand	$957	$1,293	$1,485	$2,315
	Savings	$1,641	$2,454	$1,866	$1,870
	Time	(included in analysis of all time deposits)			
TOTAL DEPOSITS		**$60,077**	**$69,707**	**$76,554**	**$78,498**

Source: Bank of Guyana: Banking System Statistical Abstract

The above table shows that typically, more than 60% of total deposits are in demand and savings deposits, and there is also a considerable short-term bias to the structure of time deposits as well. In 1998, for example, approximately 65% of the deposits in the commercial banks were savings and demand deposits, the shorter end of the maturity spectrum. Of the 35% that are accounted for by term deposits, approximately 66% were held for maturities of less than three months, and a further 20% had maturities of three to six months. Thus some 86% of the time deposits were for maturities of less than 6 months.

This means that in the banks as a whole, almost 95% of all deposits had maturities of six months or less. Indeed only GY$ 19 million of total deposits were held for maturities in excess of 12 months, while some GY$ 3.7 billion were held for maturities of 9 to 12 months.

This highlights the short-term nature of commercial bank funding, and one would reasonably expect the funding structure to impact the structure of lending on credit, as the banks have to pay attention to the critical variable of the matching of their assets and liabilities.

4.1.1 Commercial Bank Assets

A brief examination of the assets held by the commercial banks indicates that the more than 50% of their assets are held as loans to the private sector. Approximately 22% are held as loans to the public sector, including the central government as well as other public enterprises and entities, 14% are held as assets at the Bank of Guyana, approximately 6% are foreign assets and some 14% are held in other forms, presumably primarily as treasury bills.

Guyana Financial Sector Commercial Bank Assets 1996 - 1999 GY$ Million				
Sector	**1996**	**1997**	**1998**	**Aug. 1999**
Private Sector	**35,864**	**42,921**	**48,872**	**51,064**
Non-Bank Financial Institutions	**183**	**118**	**195**	**120**
Central Government	**17,250**	**18,025**	**15,851**	**16,190**
Other Public Sector	**395**	**1,620**	**2,300**	**1,923**
Foreign Sector	***3,750***	***3,498***	***3,969***	***5,705***
Due from Banks	2,453	2,153	2,694	3,494
Loans to Non-Residents	831	1,280	570	433
Other	467	65	706	1,778
Held at Bank of Guyana	***10,729***	***13,316***	***16,070***	***12,186***
Deposits	9,057	11,721	14,576	11,038
External Payment Deposits	330	318	310	89
Currency	1,343	1,277	1,183	1,059
Other Assets	**9,597**	**9,794**	**13,237**	**14,453**
TOTAL ASSETS	**77,769**	**89,291**	**100,495**	**101,641**

Sources: Bank of Guyana: Banking System Statistical Abstract

4.2 Structure of the Market for Credit

Once more, on account both of data availability and the fact that commercial banks are the largest source of credit to the private sector, the analysis of this segment refers to the commercial banks.

The following tables summarise the sectoral distribution of credit provided by the financial sector, and the distribution of commercial bank lending in terms of demand and term loans.

Guyana Financial Sector Sectoral Distribution of Loans December 1998 $ Millions				
		1998		
Sector	**Commercial Banks**	**Trust Companies**	**Insurance Companies**	**NBS**
Government	411			
Financial Institutions	195			
Productive Sector	***38,926***	***3,325***	***503***	***430***
Agriculture	8,978			
Mining & Quarrying	1,042			
Manufacturing	13,749			
Services	15,157			
Households	***9,947***	***4,196***	***192***	***4,921***
Housing	2,943	2,789	108	4,921
Motor Cars	723			
Other	6,281	1,407	84	
Total	**49,478**	**7,521**	**695**	**5,352**
Treasury Bills	**13,150**	**13**	**80**	**5,226**

Source: Bank of Guyana: Banking System Statistical Abstract

The table above shows that of total commercial bank lending to residents of GY$ 49.5 billion at the end of 1998, some $39 billion 79% has been to the productive sector, while the trust companies, as well as the NBS lend primarily to households. In the case of the NBS, this lending is entirely for housing, while the trust companies also lend for other personal reasons, in addition to housing.

Of the total value of loans outstanding to the productive sector, services, including distribution accounted for GY$ 15 billion or 39% of productive sector lending (and 31% of total loans outstanding). The distribution sector accounts for 58% of service sector loans. The manufacturing sector accounts for the next largest value of loans outstanding – 35% of productive sector loans, and 28% of total loans. Within the manufacturing sector, rice milling accounts for 37% of loans to the manufacturing sector.

Loans to the agricultural sector are next in importance and value, with the rice paddy sector accounting for 68% of agricultural loans, 16% of loans to the productive sector and 12% of total loans outstanding.

The basic picture that emerges is that commercial bank lending has been concentrated in the rice industry (23% of total loans and 29% of productive sector loans), and the distribution sector.

This pattern is in keeping with the traditional structure of credit in the commercial banking sector with the import trade and export agriculture receiving some favoured treatment in terms of the sectoral allocation of loans. The other significant sectors in the Guyana economy, such as sugar and bauxite have access to special arrangements for financing and are therefore not substantial borrowers from the banking sector.

The fact that some of the other manufacturing sub-sectors are less well served may well be an indication of the real demand for credit to such activities, but may also be a reflection of the relative scarcity of term lending that will better suit such industries, especially those geared to the domestic market.

The presumed shortage of funding that may be reflected by these data is certainly one of the arguments that have been advanced in support of the need for the establishment of a development bank in Guyana, which will be focused on term lending for productive enterprise.

This argument is reinforced to an extent by the data revealed in the next table, which summarises the allocation of loans outstanding.

As the following table shows for the period 1996 to the present, the dominant form of lending both to businesses and to individuals is in demand loans. This would include overdraft as well as other forms of demand loans. In 1996, over 71% of all lending were in the form of demand loans, with similar percentages being applied both to businesses and to individuals. By 1998, the distribution had improved somewhat to allow demand loans to account for 65% of total loans (64% in 1999), and to 68% for businesses (66% in 1999) and 52% for individuals (59% in 1999).

The sense that the increase in the proportion of term loans available is still not adequate also forms part of the demand for the establishment of a development bank. In addition, although data are not available to evaluate the contention that on average the terms of term loans may be inadequate, this also forms one of the arguments in favour of establishing a development bank.

Guyana Financial Sector Commercial Bank Loans by Maturity $ Millions						
Category		**1995**	**1996**	**1997**	**1998**	**Aug. 1999**
Demand Loans		$14,694	$22,619	$28,043	$31,587	$32,848
	Businesses	$10,933	$18,580	$23,136	$26,407	$27,069
	Individuals	$3,761	$4,038	$4,908	$5,180	$5,779
Term Loans		$5,963	$13,246	$14,878	$17,285	$18,216
	Businesses	$4,364	$11,215	$11,017	$12,519	$14,181
	Individuals	$1,599	$2,030	$3,861	$4,767	$4,035
Total Loans		$20,657	$35,864	$42,921	$48,872	$51,064
	Businesses	$15,297	$29,796	$34,152	$38,925	$41,250
	Individuals	$5,360	$6,069	$8,769	$9,947	$9,814
Demand Loans %						
	All Loans	71.14%	63.07%	65.34%	64.63%	64.33%
	Businesses	71.47%	62.36%	67.74%	67.84%	65.62%
	Individuals	70.17%	66.55%	55.97%	52.08%	58.88%

Source: Bank of Guyana: Banking System Statistical Abstract

5 A Proposed Framework for a Private Sector Development Bank in Guyana

In this section, we attempt to develop a framework on the basis of which agreement may be reached on the purpose, form and structure of a Development Finance Institution for Guyana.

5.1 Objectives of the Bank

The objectives of the proposed bank may be summarised in the following terms:

- To provide long-term project financing for new or expanding businesses;
- To provide other financial services needed by its clients including short term trade finance and other financial services;
- To facilitate the further development and widening of the financial markets in Guyana;
- To explore and develop partnership and co-operative relationships with other domestic and foreign financial service providers;
- To identify and secure sources of long term financing including domestic and external sources;
- To develop appropriate tools and systems to facilitate the growth and availability of domestic financial resources.

The above statement of objectives clearly establishes that the new institution will not be established primarily to refinance existing debt, but rather to fund new investment or expansion of existing investment, with a view to increasing production, output and exports. To do otherwise would be to create a reshuffling of such debt without any increase in production and output and would serve only to transfer risk from the existing institutions that hold such debt. This is not the purpose of the new institution.

5.1.1 Role in the Economy and Financial System

In an environment in which sources of and access to long term financing are limited and the principal form of bank financing tends to be of a short term nature, there is clearly a need for an institution to service the longer end of the market.

In doing so, however, the institution ought to expect to play a much wider role than the provision of long-term finance, difficult though that task may prove to be. An institution such as the development finance institution being contemplated here must also see itself as having a wider role in the overall development of the financial system.

This institution should therefore seek to create new mechanisms through which domestic financial resources could be released for investment in productive avenues. This would include such activities as initiating the development of a secondary mortgage market, the development of syndicated loan financing, the issue of bonds and other domestic financial instruments with long maturities, the development of a domestic stock market and similar market development activities.

While all of these activities are to be undertaken on the basis of their potential for generating profit, many of them may require special incentives from the government in order to facilitate their further development. For example, the growth of the bond market, as well as the secondary mortgage market may require the government to empower the institution to issue certain tax benefits for the bonds that it does issue. This is not by any means a new idea, as the Republic Bank of Trinidad and Tobago was allowed to raise tax-free bonds in Guyana to facilitate its purchase of the assets of the NBIC.

5.2 Ownership, Capital and Governance

As currently contemplated, the bank is intended to be at least majority owned by the private sector in Guyana. There may be a possibility that the government may be willing to hold a small minority interest, but it is very clear that the government is not seeking and does not wish to have majority or controlling interest in the bank.

This section therefore addresses some of the issues that arise in seeking to establish the bank within the private sector.

5.2.1 Company Formation and Licensing

The new institution will need to be incorporated as a company under the relevant company act in force in Guyana. This would include the creation of appropriate incorporation documents such as the Articles of Incorporation and the returns on directors.

The newly formed company will then need to make an application to the Bank of Guyana for a license to carry on a financial business. All licensees will be subject to certain fees for the establishment and operation of branches, and are required to subscribe the minimum capital required under the Act.

Licensees will also be required to observe all of the provisions of the Financial Institutions Act, 1995, in relation to its operations under the supervision of the Bank of Guyana.

From the very moment of its inception, the bank should expect to compete with all other financial institutions operating in Guyana, and under the same regulatory provisions.

5.2.2 Minimum Capital Requirements under the FIA

The FIA requires that the bank at a minimum, have $250 million Guyanese dollars (approximately US$ 1.4 million).

It is our recommendation that the domestic sponsors of the bank raise this minimum capital from among themselves, notwithstanding any possibilities that may exist for securing equity participation from institutions such as the CDB, the IFC, or the IIC, and indeed even the government itself. Equity funding that may be obtained from such sources should be used to broaden the capital base and add those elements that will encourage other investors, but must not become the majority shareholding of the bank. In any event, some of the above mentioned institutions normally require an exit provision as part of the agreement to subscribe part of the initial equity.

5.2.3 Need to Widen Potential Capital Base

While equity participation by institutions such as the CDB, the IFC and the IIC are most welcome and valuable, every effort must be made to ensure that the domestic equity participation is established on as wide a base of shareholders as possible. This is to ensure that the bank is not perceived as a closely held institution, dominated by a few individuals or influential families, and designed to satisfy the needs of such individuals to the exclusion of the rest of the market. Any such perception will undermine public confidence in the institution and consequently impair its ability to raise the funds that it would require to fulfil its mission.

5.2.4 Potential Sources of Equity Capital

It has been hinted above that there may exist the possibility of equity funding coming from institutions such as the CDB, IFC and IIC. To the extent that these are realisable sources, they will not accept, either jointly or singly, the dominant position in the institution.

In addition, in some instances, the contribution of equity participation by these institutions is based on the assumption that the help is geared toward facilitating the establishment of a private sector institution, and that any government participation must be in a minority position.

This latter is not considered to be a major issue in the case of the proposed new institution, as it is apparent that the government has already declared that it has no interest in owning or managing such an institution. What does still remain to be determined is whether the government will be interested or may be persuaded to take even a minority interest in the bank.

Apart from this, the sponsors ought to look to as wide a participation as possible. Potential sources include:

- The domestic banks and other financial institutions;
- Corporate members of the society, whether or not they are active members of the various private sector organisations such as the GMA and the PSC;
- Private individuals whether resident in Guyana or abroad.

The appropriate percentage participation by each of these sources will need to be determined as the financial structure and feasibility of the proposed institution is designed and developed.

5.2.5 Structure, Composition and Role of the Board of Directors

Concomitant with the concerns expressed in relation to the structure of the share ownership for the institution is the concern for the structure of its Board of Directors. The critical issues here is that the Board must be structured so as to be as free as possible from undue influence, interference and pressure from either the government or from any one or group of shareholders or directors.

The directors must be fully cognisant of their responsibilities to provide the bank with policy and corporate guidance, and to secure competent management to whom it will then provide stable support without allowing political considerations of any kind interfering in the proper operation of the bank.

5.3 Market Strategy and Services

The proposed institution needs to develop a market strategy, in conjunction with a long term strategic plan, that will confirm the areas in which it will seek to develop is market niche and that will define the specific methods, targets and results that it will expect to obtain.

The major elements of such strategies relate to the provision of long term project finance, the provision of other financial services, the need to raise long term funds and its interest rate strategy.

5.3.1 Project Finance

The need that initiates the concern for the establishment of a development finance institution in Guyana is clearly that for long-term project finance. Although it is at this point unclear what the size of the real market for such funding may be, it is nevertheless clear that this is the aspect of the financial market in which the need exists.

The bank will therefore have to develop the expertise and capacity to undertake the following activities in relation to its lending programme.

In defining the need for long-term capital, it must be re-emphasised that the bank’s strategy must not include the simple refinancing of existing debt where there is no substantial new production that will result from such refinancing.

Among the skills that the bank will need to develop are:

- Project evaluation;
- Structuring project funding needs to ensure an adequate balance of equity and debt, and long and short term funding;
- Developing adequate risk management tools and systems, including loan monitoring, credit evaluation and delinquency management tools;
- Developing appropriate relationships with other financial institutions to ensure that projects receive the required funding of all types needed.

5.3.2 Other Financial Services

In addition to developing the above skills for successful project financing, the bank will also have to examine the potential for providing additional services to its clients, some of which services may be on the short term end of the market. Consequently, the bank may need to develop skills in export financing and credit and in credit enhancement facilities.

The bank may also consider activities that relate to the widening of the financial system and market such as the creation of both primary and secondary markets for domestic securities.

One of the financial services for which there appears to be a demand, and which the development bank may be expected to offer, is that of providing loans in foreign currency. This would require the bank to be able to raise funding in foreign currency itself, as most of its operations will be denominated in the local currency. In any event, even where foreign currency funds may be available, the issue of foreign exchange risk arises as a major risk to the proposed bank. Indeed, from the point of view of the Bank of Guyana, this is one of the critical risk areas, both for the bank and for the country as a whole, about which it would be interested. Consequently, if the bank were to contract substantially in foreign exchange, the BOG will be even more concerned that its operations are fully subject to the requirements of the FIA.

The other aspect of this service will be the determination of who will bear the substantial foreign exchange risk involved. In other areas, where the government is owner of the development bank and the guarantor of its funding, the foreign exchange risk is essentially borne by the government. In this case, with the bank being entirely or by a substantial majority, owned by the private sector, this risk will have to be borne essentially by the borrower. In a number of cases, it is likely that this added risk could reduce the expected returns and feasibility of a proposed project.

The service of foreign exchange lending, therefore, if offered by the bank, will need to be subject to additional risk assessment and management measures.

5.3.3 Raising Long Term Funds

One of the critical ingredients in the success of the bank will be its ability to raise the required long-term funds for project lending. While external lending agencies such as the CDB and the EIB are available to make long-term loans to development finance institutions such as the bank being proposed, it is also necessary for the institution to be able to raise the funding it requires from domestic sources as well as from other external private markets.

In order to do this, and to do so without the benefit of a government guarantee, the institution will need to rely on its own credit-worthiness, built up by the reputations of its sponsors and by the soundness and profitability of its operations.

These two issues are vital to the institution’s capability of attracting the necessary long-term funds.

5.3.4 Interest Rate Strategy

Given the current nature of long-term capital markets, the new institution is likely to find that it will have only limited access to low cost, concessional long term funding, even from lending institutions like the CDB and the EIB. More than likely, a substantial proportion of its funding – if not all – will be obtained from the financial markets. This is particularly true of the funds that may be obtained from the domestic market, unless the government is willing to grant incentives for raising such domestic funding.

Against this background, it is highly unlikely that the institution will be able to make funds available at interest rates that are considerably lower than those that may be current in the domestic market from time to time.

Currently, the average cost of funds (deposits) in the commercial banks is of the order of 6.8%, while the prime rate of interest is recorded at about 17%. In such an environment, it is quite unlikely that the new bank will be able to provide funds at a significantly lower cost than the market. Among the factors that contribute to this limitation are:

- The likelihood that cost of funds to the bank will not be lower than cost of funds to the commercial banks. The latter now pay between 7.9% and 9.9% for deposits with maturities of less than six (6) months.

- The likelihood that the structure of overhead costs may be higher for the bank on account of its need to recruit highly qualified and experienced staff;

- The likelihood that the bank will have greater exposure to foreign exchange risk than the commercial banks because of the need to borrow part of its funds externally, and the absence of any government guarantee to help mitigate the foreign exchange risk;

- The need for the bank to make adequate provisions for the risks that it will accept, including normal credit risk and the higher risk attaching to new enterprises;

- The need for the bank to make an adequate return on its capital in order to present an attractive and competitive investment opportunity to potential investors.

It should be emphasised that the objective of the bank is to provide access to long-term funding at reasonable rates, and not to refinance existing debt.

5.4 Management

The Management of the bank is the second element of the need for good corporate governance, the Board of Directors being the first. The bank's success will depend on a number of managerial considerations including the following:

- The careful selection of high quality staff with strong experience in banking, financial services and project evaluation skills;

- The establishment of clearly documented policies, procedures and systems, including well developed information systems;

- The development and observance of sound risk management systems and tools, including systems for liquidity management, risk analysis and asset and liability management;

- The development of excellent skills in the selection, evaluation, monitoring and management of proposals and applications for credit;
- The development of systems for compliance with both internal and regulatory policies, procedures and guidelines. In this regard, the bank will be expected to have robust systems for internal audit, as well as external audit, for responding to comments arising from examination by the Bank of Guyana's Bank Supervisors, and for ensuring that the Board of Directors has clear and direct responsibility for ensuring compliance to all these systems.

5.5 Prudential Supervision

That the bank must be subject to the prudential supervision of the Bank of Guyana is an essential element of the corporate structure of the institution. Its inclusion under the supervisory framework will help considerably to develop public confidence in the institution, which is the most important requirement for the success of any financial institution.

It has been reported that in inviting the GMA to pursue the goal of developing a DFI in Guyana, the President may have promised to consider possible waivers of some of the provisions of the FIA. It is our strong recommendation that the new bank should seek no waivers from the FIA, and that no such waivers should be granted.

This recommendation is based on the general principle that, as the mechanisms through which the economy operates its financial and real sectors, banks and financial institutions need to be supervised by a competent authority to ensure the stability and integrity of the system and of its individual members.

In the Region, the development banks have traditionally operated under a less stringent form of supervision by the Caribbean Development Bank and have been held to less demanding prudential requirements. Unfortunately, the history of the performance of these institutions has been less than satisfactory, as a whole. In the absence of a strict enforcement of prudential standards, there has developed greater laxity in the management of the finances of these institutions and in their general management as well. There are of course very notable exceptions to this trend, but the evidence is none the less very clear. As a consequence, both the CDB and other lending institutions have begun to demand higher prudential standards of the development banks, in keeping with the standards required of other financial institutions.

As the development banks widen the range of financing instruments used to fund their loan portfolios, and increasingly use and develop domestic sources of savings, there grows an increasing need to ensure the safety of the institutions, and the protection of the domestic financial market. It is this context that the development banks are to be considered no less important or influential than other financial institutions, since any failure of the institution will be likely to extend well beyond the government finances, and significantly affect all members of the public.

5.5.1 Critical FIA Requirements

A few of the critical FIA requirements are identified below, primarily to reinforce some of the points made earlier about the need for the bank to ensure as wide as possible a participation, to be subject to prudential supervision, and to ensure public confidence.

- Minimum capital - $250 Million Guyana dollars;

- Loan Concentration Limits – subject to specific exclusions, but with the further requirement to notify the Bank of Guyana of specific large loans or concentrations:

    - Maximum loan to individual borrower – 25% of capital;
    - Maximum loan to a borrower group – 40% of capital;
    - Limit on unsecured lending to individual or group – 10% of capital for individuals, 20% for a borrower group;
    - Limit on lending to directors and officers as well as shareholders of more than 20% of the bank's capital.

- Annual license fees of GY$ 500,000 for each place of business in Georgetown, New Amsterdam, Linden, Rose Hall, Corriverton and Anna Regina. Annual license fee of GY$ 250,000 for each place of business located elsewhere in Guyana.

- Need to maintain a reserve fund funded by 15% of profits each year until the fund is equivalent to the paid up capital of the bank;

- Need to maintain a prescribed liquid assets ratio. The ratio currently in force is approximately 12% of deposits, but the minimum and the liabilities to which it refers may be specified by the Bank of Guyana for each institution;

- The need to appoint auditors and publish annual financial statements;

- The need to satisfy the Bank of Guyana that directors, officers and shareholders are "fit and proper persons" to own or manage a financial institution;

- The need to observe prudential requirements defined either by regulation or by direct letter from the Bank of Guyana in respect of the following among other issues as outlined in Section 61 of the FIA:

    - The maintenance of reserves for bad or doubtful debts;
    - The classification and reporting of past due loans, and other assets;
    - The writing off of loans or other assets which are non-collectible;
    - Interest rate risk management activities;
    - Foreign exchange risk;
    - Matters that affect the safety and soundness of the financial institutions activities.

5.6 Funding

Funding for the bank will be derived from its subscribed capital as well as from the long-term and other loan resources that it may be able to attract from the open domestic as well as external markets.

5.6.1 Raising Domestic Lending Capital

A major challenge for the bank will be to raise funds from the domestic market, in the context of the relatively narrow financial markets that now exist. The government is at present the major issuer of securities in the form of Treasury Bills issued through the Bank of Guyana.

However, while the existing market may be relatively narrow, Republic Bank of Trinidad and Tobago has been successful in raising bonds in Guyana to finance its acquisition of the assets of the NBIC. It is therefore possible to raise such long-term funds in Guyana, although the conditions and cost of any instruments that are offered for sale will come under close scrutiny.

As regards cost, the current rate on Treasury Bills is in the range of 10% for 91-day bills to and 13% for bills of maturities up to 12 months. Unless the bank could obtain fiscal concessions for its bonds, similar to those obtained by Republic Bank, then it is unlikely to be able to offer lending rates in line with current lending rates in the market.

5.6.2 Potential External Sources of Long term Funding

The development banks and development finance institutions in the Caribbean Region have traditionally been able to obtain long-term loan funding from the CDB and the EIB. No doubt, these sources will also be available to the proposed new bank, although the bank may have limited success in gaining access to the softest funds and most concessional rates in effect in these institutions.

In addition to these institutional funds, there is also the possibility that funds may be available from the wide “Diaspora” of Guyanese living abroad in the United States, Canada and the United Kingdom who may welcome the opportunity to invest in Guyana through a reputable institution committed to the development of the economy.

Apart from the considerations of the viability and soundness of the institution that will attract such investments from abroad, there is also the important consideration of the need to manage the foreign exchange risk that will also apply to such investments. This latter consideration is also of great concern to the Bank of Guyana, which is the manager of the foreign exchange variables that are so critical to the management and development of the economy of Guyana.

6 The Supporting Role of Government in Establishing the Bank

It is clear that the government does not wish to own or to manage the proposed new bank. However, the President has reportedly stated that the government will be willing to consider a programme of incentives to facilitate the establishment and operation of the new bank.

Among those incentives that the government was reported as being willing to consider was the possibility of permitting waivers to some of the provisions of the FIA. In our view, the bank will be in a far better position in terms of winning public confidence and in terms of attracting domestic and external funding if it comes fully under the provisions of the FIA. This is in addition to the salutary effect that such supervision's likely to have on the quality of the bank's day to day management.

Consequently, we recommend that the bank should not seek, and the government should not grant, any waivers or concessions under the FIA.

On the other hand, there are a number of things that the government should consider, to help with the formation and facilitate the operation of the bank.

The Guyana government is currently operating within the framework of an Enhanced Structural Adjustment Programme with the IMF, the policy matrix for which clearly defines the policy options that are feasible for the government.

An important element of the policy matrix is the emphasis that has been placed on encouraging the development of the private sector, including ensuring that the financial markets provide greater access to long-term financing and that interest rates be determined by market forces.

Equally important from the point of view of the financial sector is the focus within the policy matrix on improving the systems and management within the deeds registry to facilitate better registration of land deeds. This would assist financial institutions by making it easier to secure loans by mortgages.

At the other end of the spectrum, the government should also seek to improve the legal process supporting the ability of banks to enforce and collect on loans through the ultimate tool of foreclosure and sale. It has been reported that the existing process is extremely slow and does not facilitate effective bad loan management and collection.

In the application of the policy matrix, the government will from time to time have to meet specific targets that will limit its ability to guarantee obligations of both the public and the private sector, as well as the tax relief that it may be able to grant to business enterprises.

Within this policy framework, the government may be asked to consider providing the bank with incentives along the following lines:

- Participation, with a minority interest of no more than 20%, in the equity of the proposed new bank;

- Providing support for the bank's applications to external funding agencies for equity as well as long-term financing, and assisting by guiding the bank to sources of concessionary lending;

- Using the bank as an intermediary for special lending programmes that the government may sponsor, such as loans to small and medium size enterprises, student loans and other special programmes for which funding at concessionary rates may be available;

- Granting the bank the facility of issuing tax free bonds for the purpose of raising domestic funds for use in its long-term lending programmes;

- Encouraging the bank to initiate activities to widen the financial market such as the creation of secondary markets for mortgages. The tax-free bond facility suggested above will also satisfy this objective;

- Continuing the policy towards the reduction of interest rates by the management of the treasury bill market.

7 Strategic Options For Providing Development Finance Services in Guyana

There are a number of strategic options through which the objective of creating and establishing a Private Sector Development Bank in Guyana may be achieved. These are outlined below: Five scenarios have been identified as follows:

- A Bank Wholly Owned by the Guyana Private Sector

- A Joint Venture Between An External Bank and the Private Sector

- A Subsidiary of an External Bank with Minority Domestic Interest

- Services Provided by An External Bank Without Physical Presence in Guyana

- Encouraging Development Finance "Windows" in Commercial Banks

The following table summarises the pros and cons of each of these options.

Options for the Formation of a Development Bank in Guyana

Option	Pros	Cons
A Bank Wholly Owned by the Guyana Private Sector	• Achieves initial objective of private Sector	• Highest expected cost of start-up; • Capital resources may not be available; • Ownership may be highly concentrated; • Skill resources may be scarce; • Potential for strong influence by key persons
A Joint Venture Between An External Bank and the Private Sector	• Capital resources may be more readily available; • Managerial and technical skills may be available from partner; • Balance provided for strong local influences	• Reduced ownership by locals
A Subsidiary of an External Bank with Minority Domestic Interest	• Similar advantages to joint venture	• Local ownership further reduced
Services Provided by External Bank Without Physical Presence in Guyana	• No resources required from local promoters	• Best projects may be "cherry-picked" • No participation by locals • Supervision by BOG may be limited
Encouraging Development Finance "Windows" in Commercial Banks	• Meets "private sector" criterion; • Local banks involved; • Early start-up; • Existing framework and resources.	• Risk profile may be influenced by deposits as source of funding

8 Next Steps

As the initial promoters of the idea of creating a private sector development bank in Guyana, the Guyana Manufacturers' Association may wish to consider the following steps toward the design and implementation of the proposed institution.

1. **Approve the Conceptual Framework and Implementation Strategy.**

    - The conceptual framework for the new bank, as outlined in this paper should be considered by as wide a group as possible and, if approved, submitted to the President as the official response of the private sector to his invitation to prepare and submit a "Concept Paper".

    - One important element of the approved recommendations ought to be in respect of the preferred implementation strategy.

2. **Appoint Implementation Team**

    - Promoters of the concept should appoint a small team to further pursue the idea. This team should be given the authority to enter into negotiations with any potential partner, to oversee the development of the feasibility study and to design and form any corporate instrument that may be required to implement the bank.

    - The Implementation Team must be made accountable to the promoters of the bank, who should keep the President apprised of the progress of the implementation.

3. **Undertake Full Market and Financial Feasibility**

    - It is important to ensure that the need that is currently perceived for a development bank does in fact reflect a sustainable demand for its operations and services, and define the market niches in which the bank will operate.

4. **Establish Company and Initiate Operations**

    - The company would be established on the basis of the assessment of demand for the services to be provided. The company will be formed, subscriptions to equity capital will be invited, and application will be made to the Bank of Guyana for a license to operate as a financial institution.

5. **Open the Bank for Operations**